

Guide for Corporations That May Be Subject to the Provisions of the California Bank and Corporation Tax Law

The State of California Franchise Tax Board administers the Bank and Corporation Tax Law (B&CTL). The law is codified as Part 11 of Division 2 of Title 18 of the Revenue and Taxation Code. Under the law, a franchise tax is imposed on all banks and corporations doing business in California for the privilege of exercising a corporate franchise in California. An income tax is imposed on all other corporations that, while not "doing business" in California, "derive income from sources within California."

Definitions of Terms Used in This Guide

Corporation – An entity incorporated or qualified through the Office of the Secretary of State and/or doing business in California. For purposes of this guide, the term "corporation" does not include banks. Financial corporations are not considered to be banks and are included in the term "corporation."

The term "corporation" includes certain trusts and associations for purposes of the income tax, but does not include corporations expressly exempted from taxation by the law or the Constitution of the State of California. It also includes any limited liability company that is classified as an association for California tax purposes.

Foreign Corporation – Any entity incorporated outside California.

New Corporation – A corporation that reasonably estimates for the first income year it will have both (1) gross receipts (less returns and allowances) reportable to California of less than \$1,000,000 and (2) tax on net income that does not exceed \$800.

Calendar Year – A period of 12 months ending on December 31.

Fiscal Year – A period of 12 months ending on the last day of any month other than December.

Income Year – Calendar year or fiscal year used as the accounting period for which the net income is computed. An income year may be less than 12 months.

Accounting Period – Same as "Income Year."

Taxable Year – Calendar year or fiscal year for which the tax is due.

Doing Business – Actively engaging in any transaction for financial or pecuniary gain or profit.

Prepayment Paid Upon Incorporation or Qualification – The payment of the minimum tax of \$800 is made to the California Office of the Secretary of State upon incorporation or qualification to do business in California. The payment is for the privilege of doing business within California during the corporation's first year. This prepayment cannot be claimed as a credit against the tax reported on the first return filed by the corporation. It also may not be claimed as an estimated tax payment.

Franchise Tax

BCTL Sections 23101-23364a

A minimum franchise tax is imposed on all banks and corporations incorporated in California or qualified to do business in California through the Office of

the Secretary of State. The minimum franchise tax is \$800, except for certain credit unions, quicksilver mining corporations and gold mining corporations. Effective for income years beginning on or after January 1, 1997, SB 38 reduced the minimum franchise tax for the first income year to \$600 on qualified new corporations. The minimum franchise tax is imposed for the privilege of exercising a corporate franchise in California, and is due even if the corporation is inactive or operating at a loss.

Beginning on or after January 1, 1996, corporations that are not incorporated under the laws of California and whose sole activities in this state during an income year are engaging in convention and trade show activities may no longer be subject to the \$800 minimum franchise tax. To qualify, such corporations must engage in only convention and trade show activities for seven or fewer days during an income year, and earn gross income reportable to this state from such activities of \$10,000 or less. Qualified corporations may not be considered "doing business" in this state, but must still report California gross income and pay the corporate income tax (see below.)

For this purpose convention and trade show activities are defined by the Internal Revenue Code Section 513(d)(3)(A), and corporations engaged in convention and trade show activities for a portion of a day will be considered to have engaged in such activities for an entire day. The determination of gross income reportable to this state is made by including gross income reportable to this state of each member of a commonly controlled group.

The franchise tax is imposed on all banks and corporations that are "doing business" in California regardless of whether or not the bank or corporation is qualified to do business in California through the Office of the Secretary of State. A foreign corporation must be "doing business" in California in order to be subject to the franchise tax. For example, a foreign corporation that makes deliveries from inventory warehoused in California pursuant to orders taken by employees or independent contractor agents in California are "doing business" in California and are subject to the franchise tax even though they have no office or regular place of business in California. Similarly, foreign corporations that have employees or independent agents in California providing services on their behalf that are not exclusively in interstate or foreign commerce are doing business in California and are subject to the franchise tax even though they have no office or regular place of business in California. In contrast, a foreign corporation involved in interstate commerce whose only business activity in this state is solicitation of orders of tangible personal property by its employees or independent contractor agents is not subject to the California franchise tax. See Public Law 86-272 (September 14, 1959; 73 Stat. 555, 15 U.S.C. Section 101(a)) for more information on the types of activities that are immune from state taxation.

When a corporation becomes subject to a measured franchise tax, all income of the corporation is included in determining the measure of tax.

The corporation franchise tax is imposed for the privilege of exercising the corporate franchise in California, and is imposed on all corporations, qualified or

nonqualified, which do business in California. It is a prepaid tax for the privilege of "doing business" during the year, but is measured by the income of the preceding year. The tax for the corporation's first taxable year (whether or not a full 12 months) is the minimum tax paid at the time of incorporation or qualification in this state. Thereafter, the corporation pays a tax for each year measured by the income of the preceding year.

For more information, refer to FTB Pub. 1060, Guide for Corporations Starting Business in California.

Corporation subject to the franchise tax must file Form 100, California Corporation Franchise or Income Tax Return, or Form 100S, California S Corporation Franchise or Income Tax Return. Instructions are included with the forms.

Income Tax

B&CTL Section 23501-23572

An income tax is imposed on all general corporations which, while not "doing business" in California, derive income from sources within this state. Section 23040 states: "Income derived from or attributable to sources within this state includes income from tangible or intangible property located or having a situs in this state and income from any activities carried on in this state."

Foreign corporations that ship goods to customers in California from points outside California, on orders taken by employees or independent contractor agents in California, and neither maintain stocks of goods nor engage in other activities here, and are engaged in interstate or foreign commerce between California and other states or countries are not subject to the franchise tax. However, such corporations are subject to an income tax and must file a return unless their activities in California would be exempt from taxation under Section 101(a) of Public Law 86-272. Activities related to foreign commerce between California and a foreign country do not fall within the purview of Public Law 86-272.

Corporations subject to income tax must file Form 100, California Corporation Franchise or Income Tax Return, or Form 100S, California S Corporation Franchise Tax or Income Tax Return. Instructions are included with the forms. Unlike the franchise tax, there is no minimum income tax.

Occasionally, a corporation is subject to both the minimum franchise tax (because of qualification) and the income tax (because of deriving income from California sources though not "doing business" in California). In such event, the minimum franchise tax is allowed as an offset against the income tax.

Apportionment of Income to California

If it is determined that a corporation is subject to the franchise tax, the income tax, or both, and it derives income from sources both within and without California, the business income attributable to California is determined by an apportionment formula (See B&CTL Section 25101-25137). Generally, a four factor formula of property, payroll, and twice sales is used.

Schedule R, Apportionment and Allocation of Income, is used to apportion business income when the corporation derives business income from sources both within and outside California.

Combined Returns

When a corporation is engaged in a unitary business with one or more affiliated corporations and such unitary business is conducted within and outside California, the business income of the group is combined in order to determine the business income attributable to California. Unitary businesses operating wholly within California may elect to file on a combined basis. In general, a unitary business exists when the operation of the portion of the business done within California is dependent upon or contributes to the operation the business outside California. For more information, refer to FTB Pub. 1061, Guidelines for Corporations Filing a Combined Report.

Public Law 86-272

(73 Stat. 555 (1959) 15 U.S.C. Section 381 approved September 14, 1959)

In general, Public Law 86-272 prohibits any state from imposing an income tax on income derived within California from interstate commerce if the only business activity within California consists of the solicitation of orders of tangible personal property by or on behalf of a corporation by its employees or independent contractor agents. Such orders must be sent outside the state for approval or rejection and if approved, must be filled by shipment or delivery from a point outside California in order to be within the purview of Public Law 86-272. Orders may also be obtained for or on behalf of such corporation by an independent contractor even though such independent contractor maintains an office in California or approves the sales.

The following in-state activities (assuming they are not insignificant) are not protected under Public Law 86-272 and will cause otherwise protected sales to lose their protection under Public Law 86-272:

1. Making repairs or providing maintenance or service.
2. Collecting current or delinquent accounts.
3. Investigating credit worthiness.
4. Installation or supervision of installation.
5. Conducting training courses, seminars or lectures for personnel other than sales personnel.
6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.
7. Investigating, handling, or otherwise assisting in resolving customer complaints when the purpose of such mediation is other than to bring together the sales personnel with the customer.
8. Approving or accepting orders.
9. Repossessing property.
10. Securing deposits on sales.
11. Picking up or replacing damaged or returned property.
12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation.
13. Using agency stock checks or any other process by which sales are made within this state by sales personnel.
14. Maintaining a sample or display room in excess of two weeks (14 days) in any one location.

15. Carrying samples for sale, exchange or distribution in any manner.
16. Owning, leasing, using or maintaining:
 - a. Repair shop
 - b. Parts department
 - c. Any kind of office other than an in-home office
 - d. Warehouse
 - e. Meeting place for directors, officers, or employees
 - f. Stock of goods other than samples for sales personnel
 - g. Telephone answering service that is publicly attributed to the company.
 - h. Mobile stores.
 - i. Real property or fixtures to real property of any kind
17. Consigning stock of goods or other tangible personal property to any person for sales.
18. Entering into franchising or licensing agreements.
19. Shipping or delivering goods into this state by means of private carrier.
20. Conducting any activity which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases.

For more information, refer to FTB Pub. 1050, Application and Interpretation of Public Law 86-272.

Voluntary Disclosure Program

R&TC Section 19191 authorizes the FTB to enter into voluntary disclosure agreements with any qualified business entity in order to obtain voluntary compliance with the tax laws of the State of California. For more information refer to FTB Pub. 1071, Guidelines for Voluntary Disclosure Agreements.

Citations

The following cases are cited for your information and as authority for the data set forth in this publication:

Constitutionality

- a. Franchise Tax – *Spring Valley Co. Ltd. v. Johnson*, 7 Cal. App. 2d 258, 46 P. 2d 294 (1935).
- b. Income Tax 81^ *West Publishing Co. v. McColgan*, 27 Cal. 2d 705, 166 P. 2d 861, aff'd 328 U.S. 823, 90 Law Ed. 1605, 66 Sup. Ct. 1378 (1946).

Unitary income and apportionment by formula

- a. *Butler Bros. v. McColgan*, 17 Cal. 2d 664, 111 P. 2d 334, aff'd 315 U.S. 501, 86 Law Ed. 991, 62 Sup. Ct. 701 (1941).
- b. *Superior Oil Co. V. Franchise Tax Board*, 60 Cal. 2d 406, 386 P.2d 333 (1963).
- c. *Honolulu Oil Corp. v. Franchise Tax Board*, 60 Cal. 2d 417, 386 P.2d 40 (1963).

Combined Returns

- a. *Edison Stores Inc. v. McColgan*, 30 Cal. 2d 472, 183 Pac. 2d 16(1947).

Public Law 86-272

- a. *Wisconsin Department of Revenue v. William Wrigley Jr. & Co.*, 112 S. Ct. 2447, 120 L.Ed. 2d 174 (1992).

Other Publications

Other publications prepared by the Franchise Tax Board include:

- Form 100, California Corporation Tax Booklet
- Form 100-WE, Water's-Edge Booklet
- FTB Pub. 1038, Guide for Corporations Dissolving, Surrendering (Withdrawing) or Merging
- FTB Pub. 1050, Application and Interpretation of Public Law 86-272
- FTB Pub. 1060, Guide for Corporation Starting Business in California
- FTB Pub. 1061, Guidelines for Corporations Filing a Combined Report
- FTB Pub. 1071, Voluntary Disclosure Program

Other California State Taxing Agencies

Board of Equalization

- Consumer Use Tax Division (916) 445-9524
- Sales and Use Tax (out of State). (916) 322-2010
- Sales and Use Tax (Within California) Sacramento District Office . . . (916) 255-3350 District Offices in other cities: See the white pages of your local telephone directory
- Environmental Fees Section. (916) 323-9555 California Hazardous Substances Tax, California Solid Waste Disposal Site Cleanup and Maintenance Fees, and Underground Storage Tank Fees
- Excise Taxes Section (916) 322-9651 Cigarette and Tobacco Products, Tax, Alcoholic Beverage Tax, Emergency Telephone Users Surcharge, Motor Vehicle Fuel License Tax, Energy Resources Surcharge, California Tax on Insurers, California Tire Recycling and Oil Spill Prevention and Response

State Controller's Office

- Gas Tax (916) 445-7392

Employment Development Department

(State Disability Insurance, Personal Income Tax Withholding and Unemployment Insurance)

- Current Withholding Rates. . . (916) 255-1965
- EDD Forms (916) 322-2835
- Out of State Employers (916) 464-1056

California Tax Forms on the Internet

If you need California tax forms and publications and have access to the Internet, you may download, view and print certain California tax forms and publications. Go to the California Home Page at <http://www.ftb.ca.gov> and access the California Franchise Tax Board under state servers.

For more California tax information refer to FTB Pub. 1061.